USS

For members, for the future.

Universities Superannuation Scheme

Value for Money Supplement 2022

Value for Money supplement

Highlights

- In the latest analysis, the scheme is 24% cheaper than peer schemes, which is the equivalent of an £83m a year saving
- This has consistently been the case, with the cost advantage varying between 11% and 24% over the most recent five years reviewed
- Over the five years to 31 March 2022 we have also added significant value for members; scheme investment returns exceeded benchmark by a cumulative £2.3bn

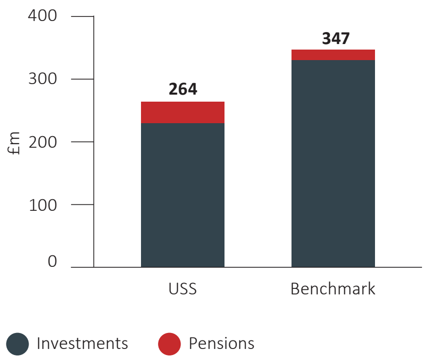
Executive summary

Delivering Value for Money is a key objective for the scheme. We run the scheme in the interests of stakeholders and this is central to our strategy and spending decisions.

Value for Money is more than considering absolute cost levels; it must take account of the benefits that are being delivered, assess the effectiveness of the resources being deployed, and balance costs with stakeholder outcomes.

How does USS compare from a cost viewpoint?

USS 2020 Cost base vs a Combined CEM Peer Group



We compare very favourably with peers, with our overall cost base being £83m p.a. (24%) lower than the combined peer benchmark.

The above analysis was derived from separate investment management and pension administration reports (compiled by the major pension sector benchmarking company CEM Benchmarking) as explained in more detail later in this report.

The scheme is significantly less expensive than peer schemes in relation to its management of investments. This is by far the largest element of total costs. CEM takes into account the investment strategy we have implemented. In section 3 we explain why we believe our approach delivers better outcomes for members than alternative investment strategies.

We are somewhat more expensive than peers for costs included in CEM's pension administration cost analysis. This covers support provided to members and employers coupled with scheme governance costs. We spend more on governance than all but one peer. We explain in more detail what we believe are the reasons for this in section 2 . Our cost advantage in investments far outweighs the impact of the higher spend on pension costs.

How does USS compare from a service and performance viewpoint?

In order to assess Value for Money, the service and performance delivered by the scheme also needs to be considered.

In relation to scheme investments, we have historically looked at our investment returns (net of all our costs) relative to a very low-cost passive benchmark. This provides one way of assessing whether our chosen strategy, which involves both active and passive management, and the costs we incur to deliver it, have added value to the fund. Looking at five-year periods ending in each of the last seven years, only once have we failed to outperform the benchmark – that was in 2021 as the economy began to recover from the COVID-19 pandemic.

We quickly returned to positive territory once again in the five-year period to 31 March 2022 where the defined benefit (DB) assets in the Retirement Income Builder showed compound growth of 7.8% p.a. adding £27.5bn to the fund. This performance was 0.62% p.a. above the passive benchmark meaning that the scheme grew by £2.3bn more (net of costs) than would have been added by investing in the passive benchmark.

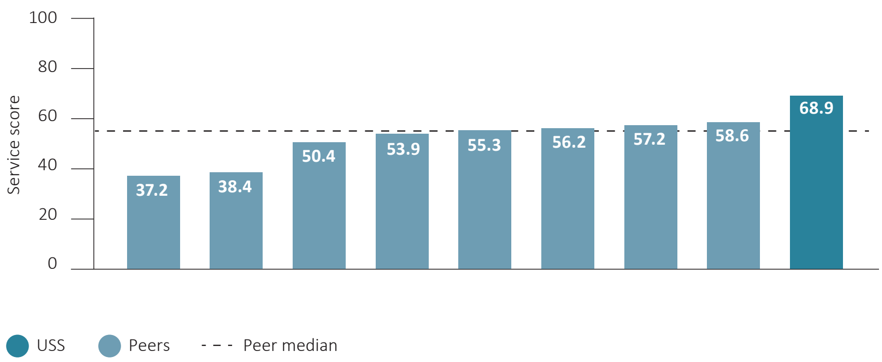
Looking at pension services, CEM Benchmarking provides us with analysis on service level as well as cost. We scored highest in the peer group for the services we offer active members, middle of the pack for deferred members and marginally below middle for pensioners. This analysis was performed before recent upgrades to our online offering for pensioners.

£2.3bn
Five year value added by USS active investment strategy

We also participate in independent benchmarking (performed by pension and investment consultancy Redington) of our defined contribution (DC) section Investment Builder against five large UK DC master trusts. Again, in this analysis we came top of the group overall; we give more details in section 4 on page 5.

When our costs, investment returns and high levels of service are taken together, we believe that they demonstrate that the scheme offers Value for Money to members (and to employers).

2020/21 CEM Benchmark: Service score – active members



1. Introduction

We operate a multi-employer pension scheme with DB and DC elements forming part of a hybrid scheme.

From a member point of view the arrangements for the costs of running the scheme are very favourable; employers fund all pension administration costs and all DC investment management costs which would otherwise be deducted from members' returns (aside from costs relating to funds members transfer in from other pension providers).

Our Value for Money focus aims to ensure that all costs incurred by the scheme are fairly priced and support the delivery of good outcomes for the scheme and its members.

This document explores in more detail:

- Cost elements and benchmarking performance (section 2)
- The choices which underpin investment strategy and their Value for Money impacts (section 3)
- Cost performance and member service delivery in Pension Services (section 4)
- Value for Money control framework (section 5)
- Conclusion (section 6)

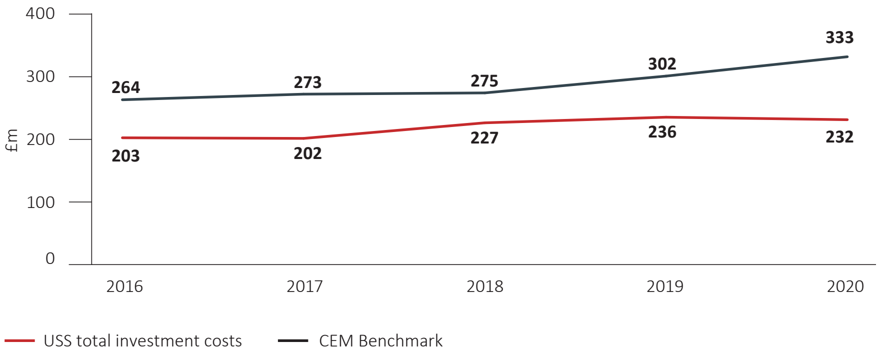
2. Cost benchmarking performance

Around 83% of scheme costs relate to the investment management of the scheme. The remaining 17% splits into the delivery costs of processing and support services for employers and members (7%) and governance and other costs (10%) (collectively referred to as pension costs below).

Investment management costs are benchmarked against a global peer group. Pension Administration costs are benchmarked against a UK peer group, as outlined in section 4 on page 5. CEM Benchmarking aims to provide like-for-like comparisons where possible e.g. through its selection of the peer group and taking account of economies of scale in pension costs and adjusting for different asset-mixes.

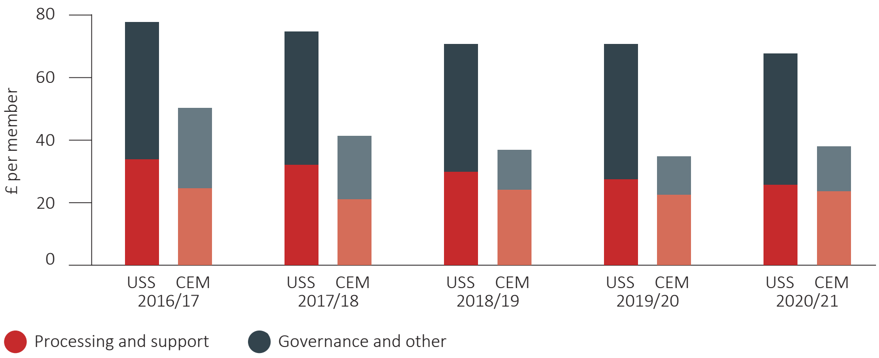
Our investment management costs, which make up around 83% of total scheme costs, are significantly below the peer costs benchmark. Costs of £232m in 2020 were £101m lower than the peer median (after scaling peer group costs to our fund size).

Investments Costs: USS vs CEM Peers (£ equivalents)



Our pension cost benchmarking shows us as broadly in line with our peers in **processing and support** services, (£26 per member versus £24 for the average of our peers), and our multi-employer, hybrid benefit and governance structure results in **governance and other** costs above our peer average (£42 per member versus £14 for the average of our peers). These **governance and other** costs include scheme governance, communications, projects (including actuarial valuations), risk & compliance and technical/quality costs. These differences drive an incremental £18m spend by USS on pension costs compared to the average peer equivalent.

Pensions Costs Per Member: USS vs CEM Peers (£ per member)



Large differences in the nature of the schemes in the peer group make comparisons other than for processing costs difficult:

- We have both DB and DC elements in the scheme, with differing reporting requirements and regulation. The DC element is an authorised Master Trust driving additional regulation and compliance work
- We undertake support activities that would usually be performed and paid for by employers. Our multi-employer, hybrid nature means that activities like DB/DC contribution splitting can be more efficiently undertaken by USS
- We provide more member decision support tools and related communications to help support members understand the benefits and options available in a combined, open DB and DC scheme
- In recent years our lengthy, challenging, and frequent valuations together with related stakeholder support have increased costs relative to our peers (some of which are unfunded schemes and therefore have no valuation costs)

Reducing service levels could marginally reduce costs, but this would be at the cost of a material reduction in the support offered to members and sponsoring employers, and so would be unlikely to improve overall Value for Money.

£101m (30%)
Investment management costs 30% below peer group

As laid out in the executive summary, our £101m cost advantage in investment management costs more than offsets the additional £18m incurred running our governance structure and delivering pension administration and benefits services.

3. Investment Strategy

Our investment strategy for the defined benefit section (which makes up 98% of scheme assets) is designed to generate the returns (for an acceptable level of risk) that meet the scheme's needs. We assess the investment returns that are delivered against a range of comparators, including a passive benchmark portfolio, which we have a strong record of outperforming. We cover our historic performance in 3.2 below.

In arriving at and implementing our investment strategy a range of choices, each with their own cost impacts, are made. We lay out our approach and rationale below:

3.1 Approach to investing scheme assets and related Value for Money considerations

Step 1: How do we decide our investment strategy?

We create a medium-term strategy aligned with the assumptions and outcomes used in the scheme's actuarial valuation.

The strategy includes a high-level allocation between return-seeking assets and lower risk/hedging assets which we believe will maximise investment returns for an appropriate level of risk.

The hedging assets seek to match the profile of our liabilities, so that the impact of changes in inflation and interest rates is aligned with the impact on our pension liabilities. To assist with managing these scheme risks whilst retaining exposure to return seeking assets, we utilise leverage (we increase the scheme's economic exposure using secured financing transactions and via derivatives).

Step 2: How do we then decide on our investment approach?

There are two broad investment approaches available to us: "active investment" and "passive investment". Active investment requires us to identify and actively manage individual investment opportunities, aiming to outperform the market which, whilst not guaranteed, USS has a strong track record of doing. Passive investment typically closely tracks a market index and thus does not aim to outperform the market. We use both approaches depending upon the risk and return requirements of the portfolio in question and the availability of suitable passive solutions. For example, we recently invested in a passive developed market equities fund tracking a lower carbon index in support of our Net Zero ambition. Where we take an active approach, the value added has significantly exceeded all related delivery costs as we explain in 3.2 below.

Whilst more expensive to deliver than passive management, active management also allows us to manage the risks of the scheme in ways that would not be practically possible under a purely passive approach for a scheme of our scale.

Step 3: How do decide whether to manage assets internally or externally?

The size of our fund means across a range of asset classes we have been able to build in-house capability saving considerable amounts compared to using third party providers. Internal management of our investments also allows us to tailor mandates to our particular needs. In some asset classes the cost differential between internal and external management is very substantial, e.g. illiquid private market assets.

Active management delivered by internal teams gives us broader market insights (if we had no in-house investment capabilities it would be more difficult to gain a deep understanding of global economic and other trends impacting the fund). This underpins our setting an appropriate strategic asset allocation and direction for the scheme.

Private markets in more detail

At 31 March 2022 c.31% or £28bn of the fund was invested in private markets. These are assets that cannot be traded on public exchanges and include equity, debt investments (such as infrastructure funding) and property. Investing in private markets is more expensive than liquid market investing; it requires more time from highly skilled investment professionals per £ invested. We, along with many other large schemes around the globe, believe that private markets deliver higher long term returns for a given level of market risks, as compensation for being less liquid. We increase our benchmark return for this portion of the scheme by between 0.75% p.a. and 1.5% p.a. to reflect this belief.

Private markets give us access to a range of investment opportunities that are not available in the public markets. This includes, for instance, investments which offer inflation protection coupled with higher returns.

External private market manager fees typically range from 1-2% of assets managed, plus performance incentives. Managing private market assets in-house costs the scheme significantly less than the asset management fees of external managers and that gap grows even larger when the performance fees they charge are taken into account.

3.2 Investment Returns

We measure investment performance against benchmarks net of all our costs of delivery. We have a track record of delivering strong investment returns, net of costs measured over both cumulative five and ten-year timeframes. We have also beaten our passive benchmark for DB assets in the Retirement Income Builder in all but one comparison period (the 2021 five-year return which was impacted by the economic effects of COVID-19).

As set out in the table below, our five-year absolute net return of 7.8% p.a. added £27.5bn to the fund. 0.62% p.a. return versus benchmark over the five years equates to a net value add of £2.3bn. The ten-year absolute net return of 9.82% p.a. added £53.2bn to the fund. 0.55% p.a. return versus benchmark over the ten years equates to a net value add of £3.1bn.

Some of our costs would still be incurred if we were to invest passively and thus a passive approach would be expected to modestly underperform a benchmark, net of costs.

Around 65% of scheme assets are currently managed internally. Were the current asset allocation to be outsourced, it would result in total costs that we estimate could be up to four times that of our current operating model. This difference is particularly driven by the cost of externally managed private market assets as discussed earlier, where fees are above 1% p.a. before factoring in performance fees in the form of carried interest. This compares to total investment cost of 0.25% of scheme assets p.a. under our current operating model.

Scheme Annualised Net Returns, after allowing for all costs (%)

	2016	2017	2018	2019	2020	2021	2022
5yr absolute net return	8.79	11.88	10.44	10.09	6.16	9.75	7.80
10yr absolute net return	5.33	6.64	7.81	11.66	8.03	9.27	9.82
5yr return vs benchmark	1.00	1.00	0.77	0.32	0.89	(0.23)	0.62
10yr return vs benchmark	0.14	0.38	0.28	0.54	0.65	0.39	0.55

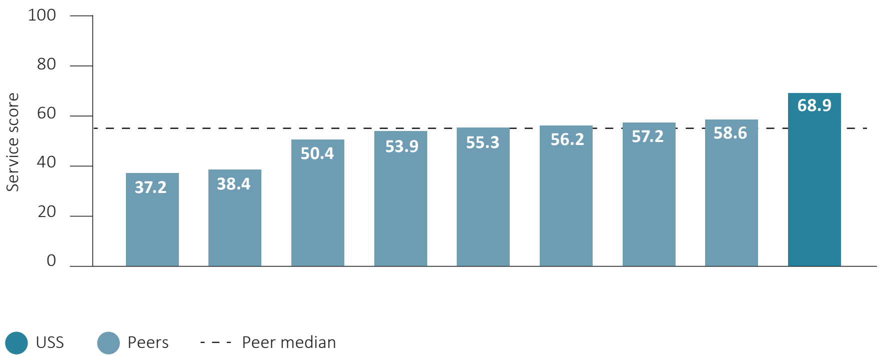
4. Pension Services

Unlike in investments, for pension costs, the schemes that CEM benchmark us against are all UK based (differing regulations around the world drives the use of a UK-only comparator group). The scheme service score was benchmarked as above the peer median in the most recent CEM survey and was top of our peer group for service to active members. We are focused on enhancing the proposition for deferred and pensioner members and are investing in digital capabilities and better member support by increasing the use of direct to member communications and targeted communications through the member's pension journey. These targeted initiatives are expected to improve our relative scoring for deferred and pensioner members in future years:

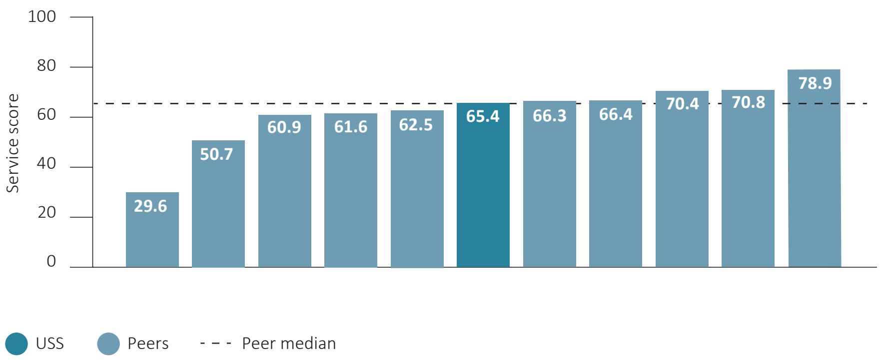
- 99.9% of retiring active member pension set-ups were completed (and their initial pension payments made) within one month of the member's retirement. The peer median is 61%
- Online registration rates are above sector norms and increasing; 57% of our active members are registered on the member portal (including 80% of DC members). 70% of pensioner members and 31% of deferred members have registered so far
- Our dedicated UK call team has a one call resolution rate of over 90%

2020/21 CEM Benchmark: Member service score vs the peer group

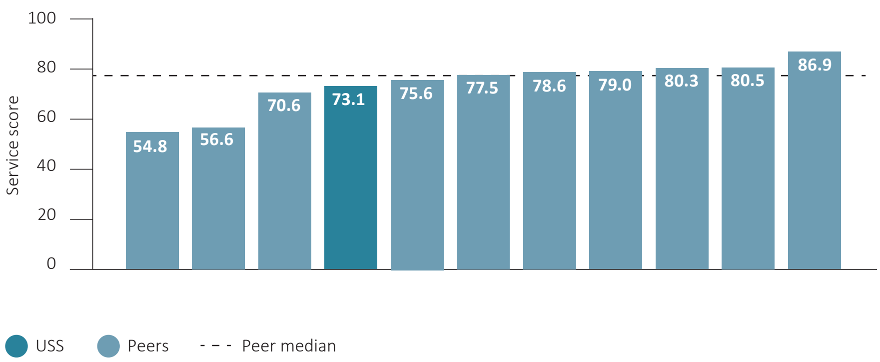
Service score – active members



Service score – deferred members



Service score – pensioners



We also take part in a benchmarking survey for the Investment Builder DC element, which is carried out by Redington, an independent pensions consultancy. A broad range of features are compared with five leading Master Trusts, including administration, investment, ESG considerations, governance, communication & tools, and pension & related services. Overall, Redington rated us ahead of all of the five Master Trusts in the peer group, scoring 4.4 out of 5 versus a peer average score of 4.1 out of 5.

5. Value for Money framework

5.1 Annual Business Planning Cycle

We have an annual business planning cycle to agree:

- Our risk appetite
- Our strategic priorities
- Key performance indicators and key risk indicators to monitor our progress
- Budgeted costs of delivery

A dashboard, monitored by the executive committee and the Trustee Board, measures progress against objectives, cost performance versus budget (including regular full year spend forecasting), key performance indicators and key risk indicators to ensure the delivery of strategic objectives within the agreed cost and risk envelope with an appropriate service level, control, and compliance environment.

5.2 Compensation costs

The USSL and USSIM Remuneration Committees, comprised of non-executive directors, review, challenge and approve compensation policy and proposals drawn up by the executive, including the design of, and targets for, performance-related remuneration.

To attract and retain high-calibre employees we offer fair salaries, acknowledging that the market rate for highly skilled financial services staff is higher than in other sectors. Annual compensation benchmarking is performed on salary and total compensation to ensure we deliver Value for Money to employers and members. We use two external benchmarking agencies: one for investment management and another for pension services roles.

5.3 Strategic Sourcing & Cost Reduction

A key Value for Money decision is which activities we should carry out ourselves, and which should an external partner provide:

- We insource where we can deliver more efficiently and effectively than third parties. Our scale results in more opportunities for us to do this, particularly in investments, compared to smaller schemes
- When making these decisions, we take account of the control required over an activity, the need for specialist skills, independence/objectivity, market availability and also whether insourcing gives us better investment insight, thus improving our overall scheme management

In the last two years, in investments, insourcing saved £20m a year in hedge fund manager fees.

In 2020 we insourced the Member Service Desk, providing a reduction in costs and a more joined-up service for our members contacting us by phone.

Each year we target additional cost savings which have not been identified when the budget was drawn up to drive identification of cost reduction opportunities without impacting employer or member outcomes. Progress is tracked and in each of the last three years we have exceeded our target.

5.4 Automation/use of technology

We regularly assess where new technology will improve end-to-end processes and reduce costs for USS and/or scheme employers, whilst enhancing members' experience:

- Most members want to receive information digitally. This increases the speed at which information can be obtained and tasks completed and reduces environmental impacts of printing and postage. Following a successful pilot, we will digitise Annual Member Statements this year
- We are digitising the new joiners process this year. This is expected to save c. 8,500 hours for our employers who currently distribute new joiner information. It will also help members receive information and access online resources more quickly

5.5 Openness/transparency

To ensure we inform stakeholders about how their scheme is managed, we provide updates including investment and cost performance via a range of published and face-to-face mechanisms.

CEM Benchmarking reports that we provide a greater level of transparency of disclosures compared with a peer group of 75 pension funds from 15 countries. We received a transparency rating of 70, compared with a UK average of 59 and a global average of 55.

The analysis considered performance, governance, cost, responsible investing, and integrated reporting disclosures.

With respect to Value for Money, key communication channels include:

- The Annual Report and Accounts which includes updates on all areas of the scheme
- Stakeholder updates and the opportunity to discuss scheme performance with the Trustee Board and the executive at the annual Institutions Meeting. A recording of the 2021 Institutions Meeting is published on the USS website at **uss.co.uk/news-and-views/views-from-uss/2022/01/01062022_institutions-meeting-2021**
- Other supporting information, published on the USS website, providing updates on a range of scheme performance areas, as well as providing updates on investment strategy themes. The "Views from USS" section of the website has regular updates on topics we believe will be of interest to stakeholders; an article on Value for Money was posted in January 2022 at **uss.co.uk/news-and-views/views-from-uss/2022/01/01242022_cost-and-value-for-money-in-uss**

6. Conclusion

Our overall proposition for employers and members benchmarks well against a range of peers:

- Our combined hybrid scheme cost is significantly lower than our peer group
- We have a long track record of strong investment performance
- Service for active members is above peer median
- We benchmark top of the DC master trust peer group across the range of product features
- We provide a greater level of transparency of disclosures than a broad range of peer schemes

We believe that this broad-based set of analyses, anchored on external, independent insight demonstrates that the scheme provides good Value for Money for our employers and members.